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ANNUAL REPORT/1986

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About the Corporation

Formed in 1910, Stelco Inc. is Canada's foremost steel-maker, supplying a third of the nation's raw steel. The core steelmaking business of the Corporation involves two integrated steel plants in Ontario and two mini-mill steel plants in Quebec and Alberta. These facilities produce plate, sheet, bar and rod products. In addition, the Corporation operates five business units which produce fasteners and forgings, wire and wire products, pipe and tubular products, cold-drawn bar products and offers advertising and communications services.

The Corporation is also involved in several joint ventures involving the production of coal and ore, grinding media, prefinished sheet steel and data processing.

*Pour obtenir un exemplaire de la
version française de ce rapport veuillez
écrire au secrétaire,
Stelco Inc.
C.P. 205, Toronto-Dominion Centre,
Toronto, Ontario, M5K 1J4*

**Stelco Inc.****NOTICE OF THE ANNUAL MEETING**

Notice is hereby given that the Annual Meeting of the Shareholders of Stelco Inc. will be held at the Concert Hall, Royal York Hotel, 100 Front Street West, in the City of Toronto, Ontario, at the hour of 10:30 a.m., local time, on Monday, April 21, 1986 for the following purposes:

1. to receive the Annual Report of the Directors to the Shareholders and the Financial Statements for the year ended December 31, 1985;
2. to elect Directors;
3. to appoint Auditors; and
4. to transact such other business as may properly be brought before the meeting.

Proxies must be delivered to the Secretary of the Corporation not later than 11:00 a.m., local time, on Friday, April 18, 1986.

Dated at Toronto, this 14th day of March, 1986.

By order of the Board of Directors

J. W. YOUNGER,
Secretary

IMPORTANT

It is desirable that as many shares as possible be represented at the meeting. If you do not expect to attend, and would like your shares represented, please sign the enclosed proxy and return it as soon as possible in the envelope provided.

Stelco Inc.

Management Proxy Circular

REVOCABILITY OF PROXY

A proxy given pursuant to this solicitation may be revoked under subsection 142 (4) of the Canada Business Corporations Act by instrument in writing executed by the Shareholder or by his attorney authorized in writing and deposited either at the registered office of Stelco Inc. (hereinafter called "the Corporation") at any time up to and including the last business day preceding the day of the meeting, or any adjournment thereof, at which the proxy is to be used, or with the Chairman of such meeting on the day of the meeting or adjournment thereof.

PERSONS MAKING THE SOLICITATION

This solicitation is made by or on behalf of the management of the Corporation for use at the Annual Meeting of the Shareholders of the Corporation to be held on April 21, 1986 (hereafter called "the Meeting") and at every adjournment thereof. Solicitation will be primarily by mail but proxies may also be solicited personally by regular employees of the Corporation at nominal cost. The cost of solicitation will be borne by the Corporation.

VOTING RIGHTS

On March 3, 1986 there were outstanding 33,765,271 Series A Convertible Common Shares and 265,436 Series B Convertible Common Shares (hereinafter referred to collectively as the "Common Shares"); 8,000,000 Series A Preferred Shares, 1,676,900 Series B Preferred Shares, 5,934,379 Series C Convertible Preferred Shares, 4,175,941 Series D Preferred Shares and 3,400,000 Series E Preferred Shares. The Common Shares together with any additional Common Shares which may be issued by April 21, 1986 are entitled to be voted at the Meeting. Each Shareholder is entitled to one vote for each Common Share registered in his name at the date of the Meeting. The holders of Series A Preferred Shares, Series B Preferred Shares, Series C Convertible Preferred Shares, Series D Preferred Shares and Series E Preferred Shares are not entitled to vote at the Meeting.

DIRECTORS' AND OFFICERS' LIABILITY INSURANCE

The Corporation provides Directors' and officers' liability insurance with a policy limit of \$10,000,000 per occurrence subject to a deductible of \$5,000 for each Director and officer to a maximum deductible of \$10,000 for all Directors and officers named as defendants in any one action. Corporate reimburse-

ment coverage is subject to a deductible of \$50,000 per occurrence. Under this insurance coverage the Corporation is reimbursed for payments made under corporate indemnity provisions on behalf of its Directors and officers and individual Directors and officers are reimbursed for losses during the performance of their duties for which they are not indemnified by the Corporation. Protection is provided to Directors and officers for acts, errors or omissions done or committed during the course of their duties as such. Excluded from coverage under the policy are illegal acts and those acts which result in personal profit. In the last completed financial year, the total annual premium of \$28,500 for Directors' and officers' liability insurance was paid by the Corporation.

PRINCIPAL HOLDERS OF SHARES

Neither the Directors nor officers of the Corporation know of any person or any person and his associates who beneficially owns, or exercises control or direction over, shares carrying more than 10% of the voting rights attached to shares of the Corporation.

APPROVAL OF THE ANNUAL REPORT AND FINANCIAL STATEMENTS

A majority of the votes duly cast at the Annual Meeting in accordance with the by-laws of the Corporation is required for the approval of the Annual Report of the Directors to the Shareholders and the Financial Statements for the last completed financial year.

ELECTION OF DIRECTORS

The affairs of the Corporation are managed by a Board of 15 Directors who are elected annually at each Annual Meeting of Shareholders to hold office until the next Annual Meeting and until their successors shall have been duly elected. The following table sets out the name of each of the persons proposed to be nominated by management for election as a Director, his present principal occupation, all other major positions and offices with the Corporation and any significant affiliate thereof presently held by him, the period or periods of service as a Director of the Corporation and the approximate number of shares of the Corporation that he has advised are beneficially owned by him or over which he exercises control or direction as of March 3, 1986. Each of such persons now is a Director and has served continuously in that capacity since his first election.

Name	Present principal occupation	Director since	Approximate number of shares owned as of March 3, 1986		
			Series A Convertible Common	Series B Convertible Common	Preferred Shares (Series)
*J. D. Allan	Chairman of the Board, President and Chief Executive Officer of the Corporation. Director and President of Stelco Coal Company (holding company), Director and President of Pikeville Coal Co. (holding company), Director and President of Stelco Holding Company (holding company)	1975	10,242		
*†Alex. E. Barron	Vice-Chairman, Canadian General Investments Limited (closed end investment trust)	1979	1,000		
*A. Jean de Grandpré	Chairman of the Board and Chief Executive Officer, Bell Canada Enterprises Inc. (holding company)	1976	125		
*†Thomas M. Galt	Chairman and Chief Executive Officer, Sun Life Assurance Company of Canada (life insurance)	1980	1,000		
*J. Peter Gordon	Corporate Director	1970	12,518		1,000 (C)
J. Howard Macdonald	Chairman of the Board and Chief Executive Officer, Dome Petroleum Limited (oil and gas company)	1984			
*A. J. MacIntosh	Partner, Messrs. Blake, Cassels & Graydon, Barristers & Solicitors	1972	750		
††William F. McLean	Corporate Director	1976	6,296		
J. Dean Muncaster	Corporate Director	1985	1,000		
J. Fraser Mustard	President, The Canadian Institute for Advanced Research (formerly Vice President of Health Sciences Department, McMaster University)	1986			
†L. G. Rolland	Chairman of the Board and Chief Executive Officer, Rolland inc. (manufacturer and distributor of fine papers)	1963	100		
†Kenneth A. White	Corporate Director	1974	300		
Marshall M. Williams	Chairman of the Board and Chief Executive Officer, TransAlta Utilities Corporation (electric utility)	1984	100		
L. R. Wilson	President and Chief Executive Officer, Redpath Industries Limited (sugar refiners)	1985	200		
*†William H. Young	Chairman, The Hamilton Group Limited (holding company)	1967	500		

*Member of the Executive Committee

†Member of the Audit Committee

††Member of the Compensation and Manpower Resources Committee

If any of the above nominees is for any reason unavailable to serve as a Director, proxies in favour of management will be voted for another nominee in their discretion unless the Shareholder has specified in the proxy that his shares are to be withheld from voting in the election of Directors.

DIRECTORS' AND OFFICERS' REMUNERATION

Nature of remuneration earned

	Directors' Fees	Salaries	Bonuses	Non-accountable expense allowance	Other	Total
REMUNERATION OF DIRECTORS AS SUCH (A) Number of Directors: 15 (B) Body Corporate incurring the expense: Stelco Inc.	\$138,150	Nil	Nil	Nil	Nil	\$ 138,150
REMUNERATION OF OFFICERS AS SUCH (A) Number of officers: 13 (B) Body Corporate incurring the expense: Stelco Inc.	Nil	\$1,931,333	Nil	Nil	Last completed financial year \$ 79,970 (1) Future years \$410,283 (2)	\$2,421,586
TOTALS	\$138,150	\$1,931,333	Nil	Nil	\$490,253	\$2,559,736

(1) Aggregate contributions to Stelco Share Participation Plan (described below) made by the Corporation during its last completed financial year for the benefit of officers of the Corporation.

(2) Aggregate of special payments, ascertainable at the date hereof and payable in future years, to which officers of the Corporation who are Participants in the Employee Stock Investment Plan (described below) are entitled subject to certain contingencies.

NOTE: Additional statutory information required pursuant to the regulations under various provincial Securities Acts.

(a) Each Director who is a non-salaried employee of the Corporation is paid \$6,500 per annum for his services as a Director. Each Director who is a non-salaried employee of the Corporation who is a member of the Executive Committee is paid \$1,500 per annum for his services as a member of such committee. Each Director who is a non-salaried employee of the Corporation and who is a member of the Audit Committee or other committee of the Board, (except for the Executive Committee) or who is designated to attend meetings of the Corporation's Pension Fund Committee is paid for such services the sum of \$500 per annum. The Chairman of any committee of the Board, except the Executive Committee (unless he is a salaried employee of the Corporation) shall be paid for his services \$1,000 per annum, such payment to be in addition to any amount to which he is entitled as a member of such committee. Each Director who is a non-salaried employee of the Corporation is paid a fee of \$450 for each meeting of the Board or of the Executive Committee or Audit Committee of the Board of which he is a member or of the Corporation's Pension Fund Committee attended by him.

(b) The nine executive officers of the Corporation, two of whom have subsequently retired, received cash compensation of \$1,602,978 from the Corporation and its subsidiaries during the financial year ended December 31, 1985.

(c) The Corporation made aggregate contributions to the Stelco Share Participation Plan (described below) during the last completed financial year of \$71,078 for the benefit of the nine executive officers of the Corporation.

(d) In December, 1985, \$241,533 was loaned to and 10,278 shares were purchased by the nine executive officers of the Corporation under the Employee Stock Investment Plan (described below).

(e) Aggregate value of Other Compensation during the last completed financial year paid to the Corporation's nine executive officers does not exceed the lesser of \$25,000 times the number of executive officers or 10% of the cash compensation set forth in (b) above.

The estimated aggregate cost to the Corporation and its subsidiaries in the last completed financial year of all benefits proposed to be paid under any pension or retirement plan upon retirement at normal retirement age to Directors and officers of the Corporation and each affiliate of the Corporation as a group: \$145,661.

STELCO SHARE PARTICIPATION PLAN

Effective January 1, 1984 the Corporation established a Share Participation Plan for all eligible non-bargaining unit employees. The Plan is funded by the Corporation through quarterly contributions to a trustee representing a percentage of salary based upon the eligible employee's position grade. Accumulated monthly entitlements are invested quarterly by the trustee in Series A Convertible Common Shares purchased from the Corporation at the closing sale price on the Toronto Stock Exchange on the third last working day of each calendar quarter. The employee may withdraw the Series A Convertible Common Shares purchased for him at any time.

EMPLOYEE STOCK INVESTMENT PLAN

Under the Corporation's Employee Stock Investment Plan established in 1983, the Corporation is authorized to advance monies to a Trustee to be loaned interest free to specified key employees and applied in payment of the subscription price of Series A Convertible Common Shares from the Corporation to be purchased by the Trustee on behalf of such employees. The amounts of the loans to individual officers are established, from time to time, by the Corporation. The loans are secured by a pledge of the Shares to the Trustee and are normally repayable within 5 years of their inception. The Plan provides, on the occurrence of any of certain specified events, for special payments to a participant to discharge his outstanding loans.

In December, 1985, \$1,083,538 was advanced under the Plan for the purchase of an aggregate of 46,108 Series A Convertible Common Shares. Of such amounts, \$277,230 was loaned to and 11,797 Shares were purchased by officers of the Corporation. These Shares were authorized for issue at a price of \$23.50 per Share, the closing price on the Toronto Stock Exchange on December 6, 1985.

INDEBTEDNESS TO THE CORPORATION

Under the Employee Stock Investment Plan above referred to, indebtedness of officers to the Corporation during the year ended December 31, 1985 was, and at present is, as follows:

<i>Name of Officer</i>	<i>Largest Amount owing at any time since January 1, 1985</i>	<i>Amount Outstanding at March 3, 1986</i>
J. D. Allan	\$162,012	\$160,689
G. W. R. Bowlby	93,276	92,528
R. E. Heneault	93,276	92,528
J. E. Hood	93,276	92,528
J. W. Younger	49,030	48,642
G. Binnie	45,548	45,187
P. D. Matthews	40,614	40,290
W. C. Ashcroft	31,837	31,584
W. A. Darby	36,872	36,579
L. M. Killaly	33,018	32,756
A. G. Northcott	35,036	34,756

INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

The management of the Corporation is not aware of any material interest of any Director or officer of the Corporation, any proposed management nominee for election as a Director of the Corporation or any associate or affiliate of any such person in any transaction since the beginning of the last completed financial year of the Corporation or in any proposed transaction that has materially affected or will materially affect the Corporation or any of its affiliates within the meaning of Section 35 (w) of the Canada Business Corporations Act Regulations.

GENERAL

Shares represented by properly executed proxies in favour of the persons designated in the enclosed form will be voted for the election of Directors and the appointment of Auditors or withheld from voting if so indicated by the Shareholder on the form of proxy.

Where the Shareholder executing a proxy specifies a choice with respect to any matter to be acted upon at the Meeting, other than the election of Directors and the reappointment of Thorne Riddell as Auditors, such shares will be voted in accordance with any specification so made. In the absence of such specification such shares will be voted for the approval of the Annual Report of the Directors to the Shareholders and the Financial Statements for the year ended December 31, 1985.

The enclosed proxy confers discretionary authority upon the persons named therein with respect to amendments or variations to matters identified in the Notice of Meeting and other matters which may properly come before the Meeting. At the date of this Circular, the management of the Corporation is not aware that any such amendments, variations or other matters are to be presented for action at the Meeting.

A proxy to be used at the Meeting must be deposited with the Secretary of the Corporation not later than 11:00 a.m., local time, on Friday, April 18, 1986.

The contents and the sending of this Circular have been approved by the Directors of the Corporation.

Toronto, Ontario
as of March 3, 1986.

J.W. Younger
Secretary

THE YEAR AT A GLANCE

Years ended December 31

Dollars in millions except as indicated*

Financial

		1986	1985	% Change Increase (Decrease)
Sales	\$	2,400.3	2,434.7	(1)
Income before extraordinary items	\$	53.8	85.2	(37)
Per cent of sales	%	2.2	3.5	
Net Income	\$	57.6	77.6	(26)
Income per common share†				
Before extraordinary items	*\$	.09	1.00	
After extraordinary items	*\$	.20	.77	
Dividends declared — preferred	\$	50.6	51.2	(1)
— common	\$	34.2	33.9	1
Per common share	*\$	1.00	1.00	
Common shareholders' equity	\$	959.2	980.6	(2)
Per common share	*\$	27.98	28.82	
Capital expenditures	\$	273.5	136.3	101
Depreciation	\$	104.4	104.0	

Operations

Materials and services bought and used‡	\$	1,404.8	1,371.6	2
Total employment costs	\$	803.8	828.7	(3)
Average number of employees		17,768	18,773	(5)
Raw steel produced — thousands of net tons		4,880	4,991	(2)
Steel shipments — thousands of net tons		4,003	4,023	(1)

**Distribution
of Total Revenue‡**

Purchase of goods, supplies and services	%	56	54	
Wages, salaries and employee benefits	%	32	33	
Depreciation	%	4	4	
Interest on long-term debt	%	3	3	
Federal, provincial and municipal taxes				
— income taxes	%	—	1	
— other taxes	%	2	2	
Dividends	%	4	3	
Earnings reinvested in (withdrawn from) the business	%	(1)	—	
	%	100	100	

† After preferred dividends. (See Note 1 on page 26 for explanation of computation.)

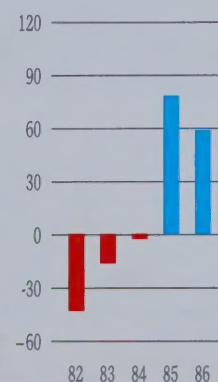
‡ Excludes extraordinary items.

Sales revenue

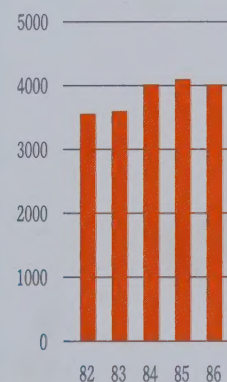
Millions of dollars

**Net income (loss)**

Millions of dollars

**Steel shipments**

Thousands of net tons



1986 RESULTS

Although Stelco's domestic market participation increased a full percentage point, due mainly to improved quality and service, and considerable progress was made in reducing iron ore costs, the earnings for 1986 were adversely affected by a number of problems, some of which could not have been predicted.

Shipments lower: Labour disputes in the container industry, the depressed conditions in the oil and gas industry, and the continued constraint by Stelco in exporting its products to the U.S. (see Steel Trade section) combined to impact negatively on shipments. Also, the upturn in business usually experienced in the months September through November did not materialize.

Production difficulties: A blast furnace breakout at Hilton Works in January, 1986, forced the Corporation to utilize steel inventories augmented by outside purchases to meet customer requirements. When the market strengthened in the second quarter, lack of steel availability from inventory meant that Stelco could not capitalize on the market upturn.

Raw steel production was lower than normal in the second half of the year because of reduced output from the BOF steel shop at Hilton Works. Construction of the new continuous casters adjacent to that facility interfered with normal production resulting in temporarily higher production costs.

Start up expenses relating to the rebuilt No. 1 Bar Mill were high reflecting the highly automated nature of the facility.

Stelco Wire Products Company experienced short-term production losses as a result of the relocation of plant and equipment arising out of its plant consolidation program.

Prices: Minimum price increases were unable to offset price discounts necessary to meet competition and thus the Corporation's average selling price was lower by \$5 per ton.

Operating statistics, 1984 - 1986

*Dollars expressed in millions,
except where indicated (*)*

	1986	1985	1984
Shipments (thousands of tons)	4,003	4,023	4,004
Sales	\$2,400	\$2,435	\$2,401
Sales price/ton*	\$ 600	\$ 605	\$ 600
Operating expense	\$2,189	\$2,187	\$2,209
Expense/ton*	\$ 547	\$ 544	\$ 552
Margin/ton*	\$ 53	\$ 61	\$ 48
Sales revenue and equity income			
less operating expense	\$ 219	\$ 249	\$ 204
Interest and depreciation	\$ 154	\$ 143	\$ 157
Pretax profit	\$ 65	\$ 106	\$ 47

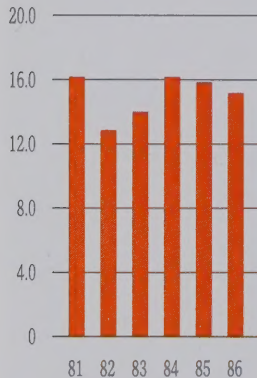


Executive officers of the Corporation: (left to right) John E. Hood, Executive Vice President; John D. Allan, Chairman, President and Chief Executive Officer, and Executive Vice Presidents Robert E. Heneault and Gordon W.R. Bowlby. Shown in the foreground is the model of the continuous caster that will be used for training operator and maintenance personnel and (inset) a construction site picture of the caster operation at Hilton Works, which is scheduled to be completed in July, 1987.

ECONOMIC AND STEEL ENVIRONMENTS

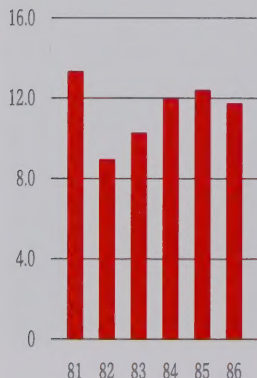
Canadian raw steel production

Million tons



Canadian domestic shipments — all steel products

Million tons



Apparent Canadian steel consumption in 1986 was the same as in 1985 with the automotive and service centre industries providing the strongest support. However, imports of all steel products increased to 20 per cent compared to 18 per cent in 1985 and this increase came at the expense of domestic producers.

A steep fall in spot world oil prices from (U.S.) \$32 per barrel to less than (U.S.) \$10, before finally settling in at (U.S.) \$15 near year-end, dealt a serious setback to the Canadian oil and gas industry. As a result, the long awaited pick-up in business investment which began in 1985 was aborted in the second quarter of 1986. The difficult conditions in this sector are expected to prevail for some time.

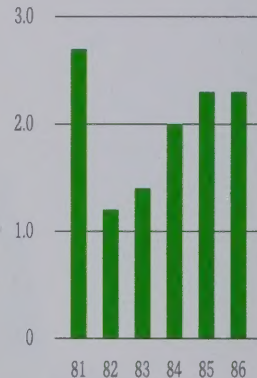
The demand for durables and non-energy investment was more promising. Strong consumer confidence, especially in central Canada, boosted sales of cars, trucks and appliances. The highest level of housing starts since 1979 spawned numerous light construction projects such as shopping plazas, schools and warehouses.

There was some improvement in world economic growth. However, apparent steel consumption in the Western World was estimated to have declined by a further 2 per cent in 1986 compared with the already depressed levels of 1985. The decline was largely attributable to the negative impact of weak oil and other commodity prices.

The drop in the value of the Canadian dollar against the major European and Japanese currencies did little to stem imports of manufactured goods, including steel, into Canada during 1986.

Canadian imports — all steel products*

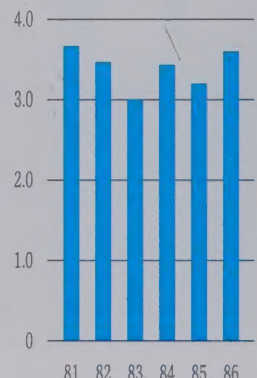
Million tons



*less imports by producers for further processing

Canadian exports — all steel products*

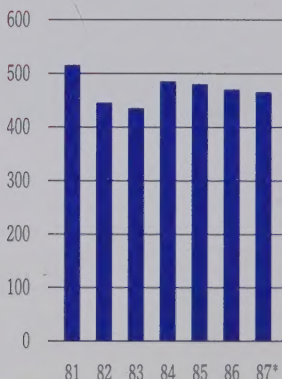
Million tons



*less exports for conversion and return

Western world apparent steel consumption

Million tons



Source: International Iron and Steel Institute

* Forecast

POSITIONING FOR THE FUTURE



In 1986, significant progress was made towards the restructuring and rationalization of the Corporation's operations. These actions form a major part of Stelco Inc.'s strategic plan to meet the challenges of a highly competitive world steel industry plagued by overcapacity.

What remains in 1987 is the completion of the major capital spending program to refurbish some of Stelco's key facilities so that they remain quality and cost competitive.

On March 31, 1986, the Griffith Mine ceased operations and its assets were liquidated. The proceeds from the liquidation at \$2.5 million were directed to the local community in order to offset lost municipal tax revenue and to assist in its economic adjustment process. In addition, a financial agreement was reached with the Ontario Housing Corporation which permits the OHC to operate the rental housing originally constructed for the mine employees

The high-tech equipment of the rebuilt No. 1 Bar Mill at Hilton Works provides a balance between automation and direct operator control.

thereby providing stability in both the rental housing market and the community.

During 1986, the Corporation closed its rock bolt manufacturing operations in Montreal and sold the equipment. In addition, the Notre Dame Works property and general office in Montreal were sold, as was the Canada Works east mill property in Hamilton and the Stelco Fabricating property in Regina.

As part of the continuing rationalization of its raw material sources, the Corporation, effective January 1, 1986, exchanged with LTV Corporation Stelco's 10 per cent ownership position in the Erie Mining Company for an additional 8 per cent ownership position in the Hibbing iron ore mine bringing Stelco's total ownership in Hibbing to 14.7 percent.

Stelco participates in a number of raw material joint ventures, including some in which Wheeling Pittsburgh Steel Company and LTV Corporation are also associated. On July 17, 1986, LTV Corporation filed for protection under Chapter 11 of the U.S. Bankruptcy Code. Wheeling Pittsburgh Steel Company had previously sought protection under this code. The ultimate effect on Stelco of these bankruptcy filings is indeterminate.

Stelco Core Business: 1986 sales... \$1,877.7 million

The capital spending peak for the major modernization programs in the core business area is past. The facilities involved will all become operational in 1987. Capital spending in future years will primarily be restricted to programs that will ensure the core business facilities remain efficient and cost-effective.

Stelco's core business is now divided into three main product groupings: Hot Rolled Sheets and Plate, Cold Rolled Sheets and Coated Sheets, and Rod and Bars.

The accountability for the growth and profitability of each group rests with the General Sales Managers and the General Managers of the works that manufacture these products and the Vice-Presidents of sales and manufacturing.

Hilton Works: At Hilton works, the start up of the combination bloom/slab caster is scheduled for July, 1987, closely followed by the slab caster in September, 1987. Both will feature advanced and innovative technologies, including computerized process control and quality monitoring on a slab-by-slab basis. *When these casters are in*

full production, more than 80 per cent of Stelco's raw steel production will be continuously cast.

The revamp of the No. 1 Bar Mill is complete and the mill commenced operation in September. The quality of the product is excellent and the cost savings predicted for this project should become evident in 1987.

The optimization of the Basic Oxygen Furnace Shop is progressing on target with completion scheduled to coincide with the startup of the continuous casters.

Improvements to the 4-stand cold mill are scheduled for completion in August, 1987. These modifications include the installation of hydraulic gauge control, speed and tension controls on all stands and improved x-ray gauges. When completed, the mill will be capable of producing a superior quality product.

Lake Erie Works: The addition of a fifth rolling stand, an increase of horsepower on the other four stands and the installation of hydraulic automatic gauge control is well underway for the hot strip mill. These improvements will permit the mill to roll wider and thinner strip at closer tolerances which will result in a significant yield increase. The improved product will meet the tighter gauge tolerance and surface quality needs of the marketplace. Completion of this project is scheduled for August, 1987.

Considerable success has been achieved in hot charging slabs from the continuous caster to the hot strip mill without the need for preconditioning. This will eliminate the intermediate steps between major stages of the steel processing sequence, with attendant cost savings.

McMaster Works: Changes to the continuous caster moulds combined with modifications to the cooling bed have resulted in billets of improved shape and straightness. The quality and surface finish of the long billets required for the No. 1 Bar Mill and No. 2 Rod Mill at Hilton Works have also been enhanced.

Edmonton Steel Works: Good results have been achieved in the development of very high quality steels for the grinding media industry.

Modifications are also planned for the steelmaking process and the bar mill in order to enhance overall product quality.



Further improvements in surface quality and better gauge control will result from increasing the horsepower on the existing four stands and the adding of a fifth stand to the hot strip mill at Lake Erie Works. The fifth stand (inset) is shown at the premises of Wean United Canada Limited, Cambridge, Ontario, where it is being assembled and tested before its incorporation into the mill.

Stelco Business Units: 1986 sales... \$522.6 million

The profit centre concept first introduced in 1983 has now been expanded to five strategic business units. These are: Stelco Fastener and Forging Company; Stelco Pipe and Tube Company; Stelco Wire Products Company and the two recent additions, Canadian Drawn Steel Company and a new communications facility, Avenue Studios.

The rationalization and regrouping of the facilities involved in setting up these units has been completed.

Stelco Fastener and Forging Company: Stelco Fastener and Forging Company has reduced the number of fastener plants from four to three with no loss in production capability. Brantford Works has been expanded and the Gananoque forging operation is having some units refurbished in anticipation of higher operation levels in 1987.

Stelco Pipe and Tube Company: Stelpipe has consolidated operations at Welland, Ontario, and operates plants in Camrose and Edmonton, Alberta.

The pipe business, which is heavily dependent on the oil and gas industry, will continue to be difficult for the near future.

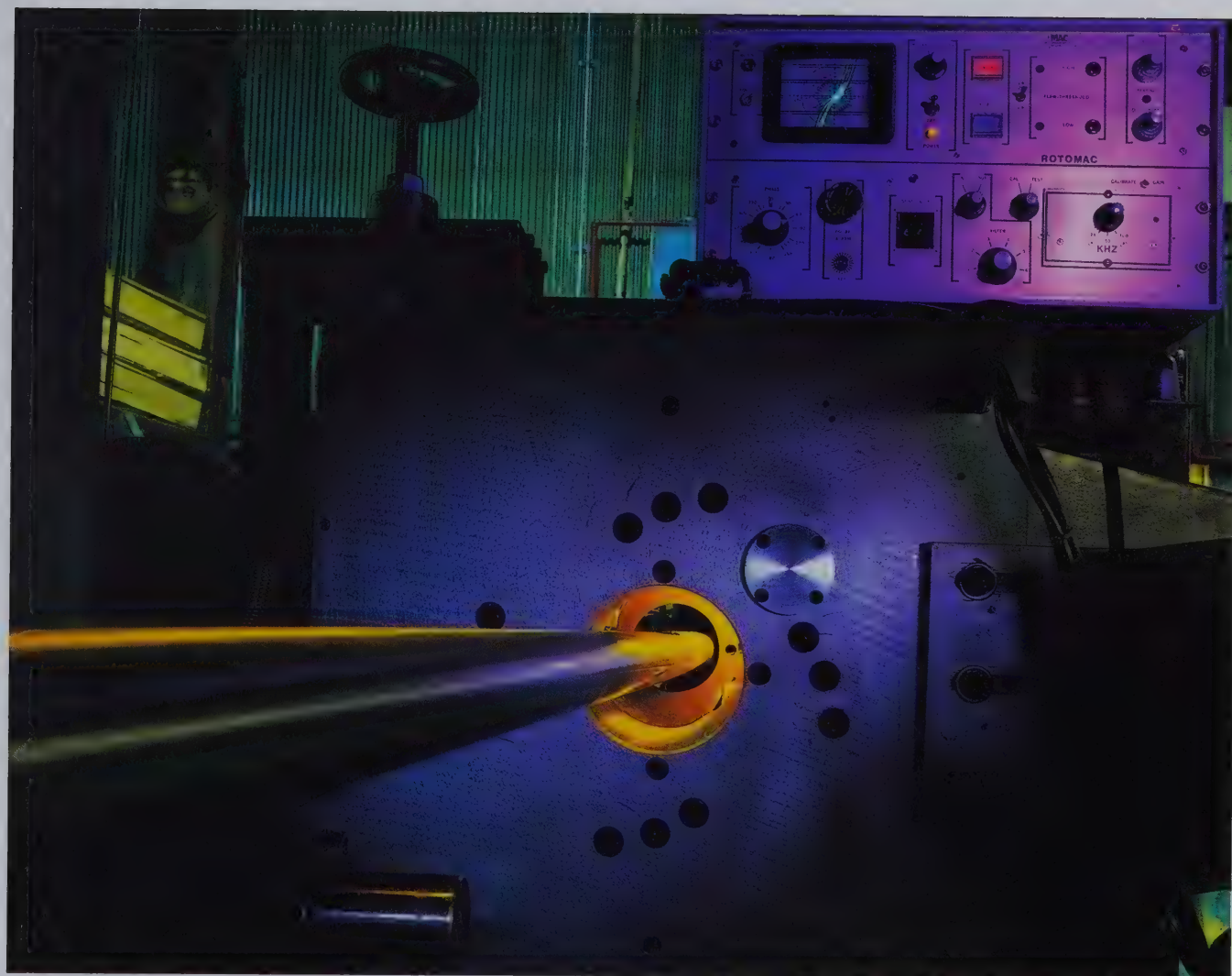


State-of-the-art equipment such as this computer-controlled multi-hole wire drawing machine has earned Parkdale Works the reputation of being one of the most modern and efficient wire mills in the world.

The goals are to consolidate Stelpipe's position in traditional markets, diversify into products with more value added and restructure for cost improvement.

Toward these goals, two major capital projects are underway at the Page-Hersey Works in Welland, Ontario. The Continuousweld Pipe Mill is undergoing a major revamp to achieve improved efficiency, reduce cost and to upgrade product quality; a 50 per cent increase in the capacity of the Cold Draw operation is also in progress which will enable Stelpipe to expand its market participation at lower costs.

Stelco Wire Products Company: In 1984, Stelwire operated six plants. It now operates four and by installing state-of-the-art equipment has maintained the same tonnage capability.



The consolidation has also enhanced Stelwire's ability to respond to the ever-increasing demands for service and quality from its customers. In addition, communications with customers will be further improved with the implementation of a computerized order status system.

Canadian Drawn Steel Company: Canadian Drawn Steel Company became a strategic business unit on November 1st. It is the largest supplier of cold finished bars to the Canadian market, operates a modern plant in Hamilton and is an important supplier to the automotive industry.

Avenue Studios: Avenue Studios was formed July 2nd as a result of the rationalization of Stelco's communications and advertising requirements. It is now a full-service advertising agency serving both the Corporation's needs as well as those of outside clients.

At Canadian Drawn Steel Company, highly sophisticated, non-destructive testing units, incorporated into the production line, ensure consistently high quality bar products.

Stelco Pipe and Tube Company was again honoured when Page-Hersey Works was awarded "Self-Certification" status by General Motors. The award, the second one received from GM, was given for axle tubing produced at Stelpipe's tubing facilities; further proof of Stelco's quality people producing quality products.



Quality and service

North American manufacturing is engaged in a major effort to improve productivity and quality. As a supplier of a basic material to this sector, Stelco is making every effort to assist in this process. Investment in new equipment and technology at Hilton Works, Lake Erie Works, Edmonton Steel Works, McMaster Works, Research and Development and Stelco's Business Units over the past decade has reached \$1.4 billion. In addition, Stelco has systematically developed Quality Assurance into all its systems and procedures. For example, the program provides assurance in measuring systems for accurate data process monitoring by Statistical Process Control and the certification of purchased material properties. All such procedures are monitored by regular internal quality audits to ensure that procedures are being adhered to and improved where necessary.

The successes in these endeavours have been recognized by the numerous quality citations awarded including Ford's Q1 award, certification awards from several General Motors plants, the Eaton Corporation and Chrysler.



Quality products from bolt makers such as this one at Stelco Fastener and Forging Company's Swansea Works, led to a Ford Q1 award for that plant.

Stelco's quality assurance has resulted in increased business in sensitive markets — particularly the automotive wheel market where the Corporation's quality rates with the best in the world.

Stelco's Customer Integrated Planning (CIP) program continues to attract more customers. The CIP technique is capable of reducing inventory at the steel plant and at the customer's manufacturing plant without deterioration in service.

Research and development

The focus of the research and development activities at Stelco continues to be directed to innovative and applied research programs designed to reduce costs.

A major program was initiated to improve gauge control of steel rolled on the 56-inch Hot Strip Mill at Hilton Works. The program is centred around a computer-based, feed-forward control system. Further improvements, including a computerized operator assist system, were made to the 5-Stand Cold Mill to ensure product consistency.

New machinability test facilities were acquired to support the Corporation's goal of becoming a leader in the manufacturing and marketing of free-machining and engineering bar steels. Machinability data generated on these facilities led to a modified mill rolling practice for improved performance of free-machining bars. In one specific case, *the studies led to the development of a new design for a cutting tool which was subsequently adopted by a major automobile manufacturer.*

An experimental program was initiated to develop improved steel suspension components for the automotive industry. Working with major customers, Stelco aims to provide higher strength rod and bar products for fabrication into lighter, more corrosion resistant coil and leaf springs.

A joint development program was also undertaken with major producers of automotive wheels to incorporate higher quality, continuously cast steel into their operations. The program, which is showing excellent results, involves the application of new steels that are compatible with the customers' flash-butt welding processes and includes recommendations for changes to customers' equipment to achieve better final quality.

Extensive investigation continued on a wide-ranging program to develop new or improved coatings and coating procedures for sheet products destined for the critical automotive, prefinished steel and container markets. *Stelco is now supplying high quality sheet steel for surface-critical auto body applications.*



A computer-controlled scanning electron microscope at Stelco's Research and Development Centre furnishes R & D specialists with detailed analyses of steel samples and surfaces of metallic specimens. It has a dual function capability of quantitative image analysis and identifying chemical elements.

University research activities

Stelco's continuing association with universities is a valuable means of augmenting the Corporation's research activities by involving, through interactive research programs, some of the country's most knowledgeable professors and brightest graduate students. It also helps to keep the Corporation at the forefront of developing technologies.

This involvement includes two university chairs in metallurgy, one at McMaster University in Hamilton, Ontario, and one at the University of British Columbia in Vancouver, British Columbia, three graduate research fellowships, and several other forms of collaboration.

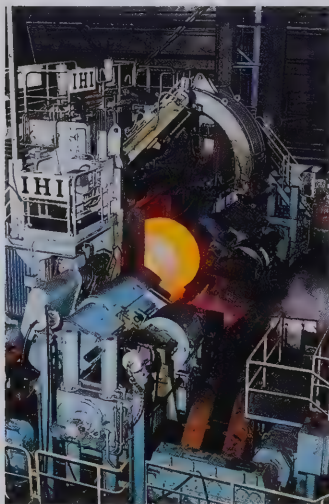
Interactive studies are in progress on many subjects such as cokemaking, ironmaking, continuous casting, hot-rolling and galvanizing technologies. Studies in progress at the University of British Columbia have assisted in upgrading Stelco's continuous casting operations and have included mathematical modelling of the hot strip mill at Lake Erie Works. Studies at the University of Waterloo are identifying ways to raise the efficiency of coke oven operations.



Machineability data generated on this numerically-controlled turning centre led to the development of a new design for a cutting tool by Stelco's researchers which was subsequently adopted by a major automotive manufacturer.

The limiting dome height tester is used to determine specific formability qualities of steel used for critical automotive parts.





The first Stelco Coilbox in Japan was commissioned June, 1986, for Kawasaki Steel Company's 2030 mm hot strip mill at its Chiba Works in Chiba City near Tokyo.

Marketing Stelco's technology

Stelco markets the Corporation's technology through a Technical Services Group whose main responsibility is to promote the sale of the Corporation's unique inventions to other steel producers throughout the world. Significant revenues from this activity have been achieved.

Stelco has pioneered a number of steelmaking processes and related developments, not the least of which is the Stelco invented Coilbox — a major technical innovation in the rolling of hot strip. By the end of 1986, seventeen Coilboxes had been licensed for operation in many countries including Japan, Sweden, Australia, Belgium, West Germany, the United Kingdom, New Zealand, the United States and Canada.

Employee relations

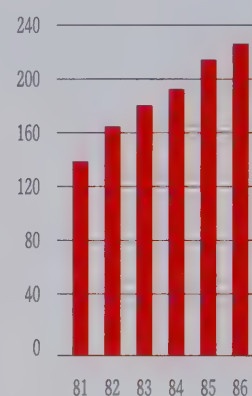
Continuing information exchange meetings, started some years ago, between Stelco management and the executives of various union locals were held throughout 1986. These informal meetings, under alternating chairmanship, provided an opportunity for the participants to review labour

Employment Costs

<i>Dollars in thousands</i>	1986	1985
Wages and Salaries		
For time worked	\$ 613,613	\$ 613,952
For vacations and statutory holidays not worked	60,584	63,389
	\$ 674,197	\$ 677,341
Supplementary Employment Benefits		
Pension costs	\$ 25,797	\$ 54,401
Group insurance plans and other benefits	64,998	61,806
Unemployment insurance and worker's compensation	38,833	35,128
	\$ 129,628	\$ 151,335
Total Employment Costs	\$ 803,825	\$ 828,676
Average Number of Employees	17,768	18,773
Employee Benefits		
Number of pensioners at year end	8,332	7,913
Pensions paid during the year	\$ 69,876	\$ 58,309
Total life insurance at year end	\$ 795,200	\$ 824,228
Total death benefits paid during the year	\$ 3,642	\$ 4,272

Shipped tons per employee

Net tons



Chairman, President and Chief Executive Officer John D. Allan meets with Stelco University Scholarship award winners Erika Casperson (left) and Sonia Dusil. One hundred and twenty-nine scholarships with a total value of \$123,500 were awarded to the children of employees and retirees during 1986.



relations, operating and marketing developments of direct interest to the parties. Ongoing discussions also took place with the executive of Local 1005 Hilton Works with respect to technological changes emanating from the rebuilding of No. 1 Bar Mill and the installation of the continuous casters. All of the Corporation's collective agreements with employees represented by the United Steelworkers of America expire on July 31, 1987. Agreements with other union locals will come up for renewal later in the year.

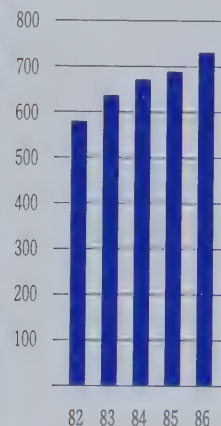
Health and safety issues achieved a higher public profile during the year than ever before. *The initiatives undertaken by Stelco to attain its objective of providing employees with a safe and healthful working environment continued to withstand increased public and regulatory scrutiny.* The principle of internal responsibility for such issues forms the basis of the joint Company-Union Health and Safety Committees functioning at all plants.

As part of the Corporation's program of rationalization and restructuring, Canada Works in Hamilton and Griffith Mine at Red Lake, Ontario, were permanently closed. Flowing from the assistance program designed by Stelco for employees displaced by plant closures, personnel at these facilities became eligible for substantial separation allowances and improved pension benefits.

Continued emphasis was placed throughout 1986 on the development of the Corporation's human resources. A total of 4,334 employees have now been trained in the techniques of Statistical Process Control, while virtually all managers and supervisors have undergone instruction in

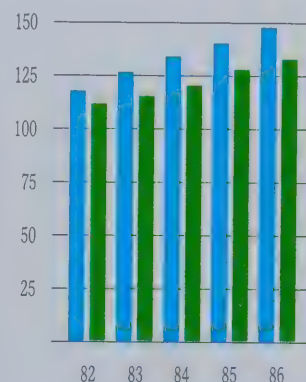
Employees' average weekly earnings

Dollars per week



Consumer price index increases compared to employees' earnings increases

■ Average weekly earnings percent increase
■ Consumer price index percent increase
(Base 1981 = 100)



Interaction Management, which focuses on the practice of effective human relations. Additional training programs dealing with upgrading employee skills were also carried on throughout the year.

One hundred and twenty-nine scholarships with a total value of \$123,500 were awarded to the children of employees and retirees during 1986. Tenable at any university or college recognized by the Association of Universities and Colleges of Canada, these scholarships were established in 1985 to mark Stelco's 75th Anniversary and to recognize the contribution made by employees over the years to that achievement.

Significant Marketplace Issues

Steel trade: The lobbying activity in which Stelco has involved itself to counter attempts to be included in a global U.S. quota system has given the Corporation an insight into what the best course of action regarding trade for North America should be. Only by creating a North American trading community can the world's two largest trading partners improve the competitive position of their own industries and, at the same time, adopt common measures that will deal with unfair aspects of international trade.

There are many sectors of Canada's economy, other than steel, which are now being exposed to the unilateral action of the United States as that country deals with its trade deficit. This is confirmation of what Stelco has repeatedly said could happen: the lack of a bilateral trade agreement will only lead to misunderstanding and the implementation of retaliatory measures that are not in the interests of either country. New ground rules must be established that are common across all sectors so that trade can get back to some normalcy and expand in both directions. A bilateral trade agreement is critical to the establishment of these ground rules, particularly in the areas of tariff reductions, non tariff barriers and contingency protection measures, including safeguard actions, countervail (subsidies) and dumping. The Canadian steel industry can handle elimination of tariffs over an appropriate time period but, in the other areas, we need a new set of negotiated rules which recognizes that Canada is different from the other trading partners of the U.S.

Canadian Steel Producers Association

A growing realization among Canadian producers of raw steel that they needed to act collectively to deal with trade issues led them to form the Canadian Steel Producers Association (CSPA). The Association, headquartered in Ottawa, represents all fourteen steel producers. Its principal aim is to maintain Canada's favourable balance of trade in steel which has been built up carefully over a long period of time. This means protecting the access to the U.S. market and endeavouring to keep imports under control through market action or unfair trade complaints.

Canadian steel exports to the United States

U.S. statistics show that steel imports from Canada during 1986 provided some 3.6 per cent of U.S. apparent consumption, a level which has caused concern that President Reagan's steel program is being undermined. In aggregate, CSPA members have reduced their share of steel exports to the U.S. since the initiation of that program, leading them to believe that certain other exporters are not demonstrating the prudence in their shipping pattern that originally led Canada to assure the U.S. of support for its steel program. In fact, there are now as many as 700 steel exporters from Canada to the U.S. with a significant portion being new entrants in 1985 and 1986.

A procedure has been developed by Canadian producers of raw steel and certain end products, as well as the Canadian Steel Service Centre Institute, whereby export statistics are reported on a priority basis to the Canadian government. This will indicate volume trends in advance of published U.S. statistics.

Stelco's exports to the United States

Stelco was one of the key players in achieving an exemption for Canada from the U.S. voluntary restraint agreements program, something Canadian steel producers cannot live with because of product by product restrictions and short lead time native to our business across the border. In the Fall of 1984, when the President's program was initiated, most of the Canadian raw steel producers agreed to act prudently. It was also understood that total Canadian steel exports to the U.S. should be at 3 per cent to avoid reaction.

Canada did play its part in 1985 as the chart indicates but, in 1986, despite the effort of Stelco and some other producers, surging took place, particularly by the many new entrants referred to earlier.

In 1984 Stelco's exports to the U.S. peaked. In order to show constraint and co-operation with the President's program, Stelco's exports declined 7 per cent in 1985 and a further 9 per cent in 1986 — in both cases the Stelco reduction was greater than the decline in U.S. apparent consumption that took place in each of those two years.

These reductions were undertaken by Stelco even though the value of goods and services imported by Stelco from the U.S. exceeded the value of its exports to the U.S.

Stelco does not intend to allow its U.S. market participation to deteriorate any further. Stelco has shown leadership in dealing with this issue; now it's up to other exporters to show restraint. In Stelco's opinion the Federal Government must now deal aggressively with the issue. It must determine who all the new exporters are and take a lead role in controlling the situation. Stelco does not want a "made in U.S." solution.

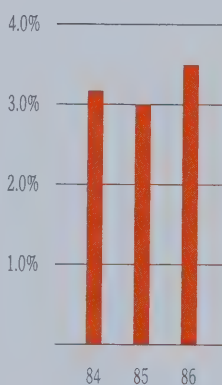
Steel imports into Canada

There was a definite increase in import penetration that started early in the year. This is, of course, attributable to the U.S. controls on imports to that country which is prompting overseas producers to seek sales in Canada. Imports accounted for 20 per cent of the domestic market compared with 18 per cent in 1985. The U.S. continues to be the largest exporter to Canada.

The high level of imports into the country, coupled with the potential for passthrough to the U.S. to avoid formal constraints, caused the Canadian Government to initiate a system of import permits to monitor the flow of steel into Canada. This system provides a more timely information base which will assist the industry to confirm losses of business due to unfair trade and result in speedier unfair trade complaints.

One specific unfair trade complaint initiated by Stelco regarding seamless standard pipe from Brazil, resulted in Revenue Canada applying a countervailing duty averaging \$74/N.T. against future importations from that country until the Canadian Import Tribunal rules whether Stelco has been injured. Stelco is currently analyzing the basis for additional complaints.

Canada's % of U.S. apparent consumption



Canadian Steel Trade Conference

The second Canadian Steel Trade Conference, which was held in May 1986, proved to be even more valuable than the first conference held in 1985 because of the representation from all levels of governments and subsequent meetings in Ottawa with the Prime Minister and cabinet ministers. This organization was responsible for lobbying the government to put the import permit system into place. Perhaps even more notable, it may well be the first private sector organization in Canada to have been given the responsibility for dealing with the adjustment process relating to employees who became redundant through technological change or downsizing.

Steel for beverage cans

Programs to ensure that steel cans remain the most cost-effective containers for this market are now in place.

The multi-material curbside collection and recycling network which the steel industry, through the Canadian Tinplate Recycling Council, is helping to develop across Ontario is progressing well. The number of households serviced is doubling every year with 40 per cent of targeted households, some 900,000 homes, to be involved by the spring of 1987.

The establishment of this network is critical in order to meet the intent of the regulations set down by the Ontario Ministry of the Environment.



With the commissioning of Moly-Cop Canada's new steel forging and heat treating plant in Kamloops, British Columbia, on September 30, the mining industry now has access to Canada's largest supplier of grinding media. Moly-Cop Canada, a joint venture of Stelco Inc. and Armco Canada Ltd., can produce a technologically superior product designed to meet the exact needs of the customer.

Other 1986 Highlights

Start up of joint venture: On September 30, Moly-Cop Canada, a joint venture of Stelco and Armco Canada Ltd. came on stream. Located in Kamloops, British Columbia, this \$11 million steel forging and heat treating plant will employ 55 people and will produce in excess of 55,000 tonnes of grinding media annually. Stelco's Edmonton Steel Works plant will supply the steel for Moly-Cop's processing line.

The Kamloops facility will be the second largest grinding media plant in the world. It will share in the technical developments in other Armco plants located in Europe, South America, Asia and the United States.

Strategic planning: An essential part of Stelco's strategic planning process is the development of a broader corporate strategy designed to carry the Corporation profitably through the next ten years. During 1986 an in-depth review of the Corporation's current business was undertaken. It has been determined that future growth must involve adding value to current businesses as well as diversification into some new business areas — areas that are specifically geared to improving the Corporation's returns on equity and capital employed. A committee of the Board of Directors has been established to monitor the development of this broader corporate strategy, and to provide guidance where appropriate.

Executive changes: In 1986, Mr. F.A. Hoyle and Mr. W.A. Darby retired from the Corporation. Mr. Hoyle, most recently Vice President — Manufacturing Services, served Stelco Inc. for 36 years. Mr. Darby served the Corporation for 31 years, becoming Assistant Comptroller — Corporate Accounting and an officer of Stelco Inc. in 1976. Both Mr. Hoyle and Mr. Darby made significant contributions to the progress of the Corporation during their careers.

J.D. Allan
 J.D. Allan
 Chairman, President
 and Chief Executive Officer

FINANCIAL REVIEW

The following discussion of significant elements of operating results and financial position is provided as an adjunct to the consolidated financial statements and related notes of the Corporation. A ten-year statistical summary of key operating and financial data is given on page 38 of this report.

Revenue

Sales revenue in 1986 was \$2,400.3 million down \$34.4 million from the record level achieved in 1985. The main reasons for the revenue decline were reduced steel shipments brought about by labour difficulties in the container and construction industries and by the general malaise in the gas and oil sector. In addition, sales revenue was restricted by a break-out early in the year at a blast furnace at Hilton Works. While costs associated with this interruption were largely covered by insurance, the lack of hot metal limited an opportunity to take full advantage of an upturn in demand in the second quarter.

Equity income from corporate joint ventures and partnerships improved to \$7.5 million from \$.8 million in 1985. The improvement largely results from the exchange of the Corporation's 10% interest in the Erie Mining Company for a 24.1% interest in the Hibbing Development Company. Details of this exchange are given in Note 7 to the consolidated financial statements.

Net Income

Income before extraordinary items was \$53.8 million down from \$85.2 million in 1985. Earnings per common share before extraordinary items and after preferred dividends were \$.09 in 1986 versus \$1.00 per share in 1985.

Extraordinary items net of taxes resulted in a gain of \$3.8 million in 1986 compared to a loss of \$7.6 million in the previous year. Note 3 to the consolidated financial statements provides details of these items.

Net income after extraordinary items was \$57.6 million for the year down from the \$77.6 million in 1985. Earnings per common share after deducting preferred dividends were \$.20 versus \$.77 in 1985.

Dividends

The common share dividend rate was maintained at 25¢ per quarter during 1986 and 1985. Dividends declared on both Series A and B Convertible Common Shares amounted to \$34.2 million in 1986 up slightly from the \$33.9 million declared in 1985. The increase represents the dividends associated with shares issued under the Stelco Share Participation Plan and the Employee Stock Investment Plan.

Preferred share dividends declared on all series amounted to \$50.6 million in 1986 down slightly from the \$51.2 million declared in 1985. The decrease results from the general reduction in prime interest rates on which the Series A dividend is based and the reduced number of Series B shares outstanding.

Capital Structure

During 1986 changes to the capital structure were relatively minor. Issues of common shares made during the year primarily were 216,017 Series A Convertible Common Shares issued for a total consideration of \$4,950,151 under the Stelco Share Participation Plan and 4,572 Series A Convertible Common Shares issued in December for a total consideration of \$86,297 under the Employee Stock Investment Plan. Details of these two plans are given in Notes 12 and 13 to the consolidated financial statements.

Some Series B Preferred Shares were purchased and cancelled in accordance with the terms of that issue. In addition, during 1986, 2,699,850 warrants expired and their stated capital of \$14,849,175 was transferred to contributed surplus. Both of these transactions are described in Note 11 to the consolidated financial statements.

Cash Flow

The following comments relate to items set out in the Consolidated Statement of Cash Flow on page 24 of this report. Short-term investments are treated as cash for purposes of this statement.

Cash from Operations: In total, cash from operations was \$18.2 million in 1986 down from the \$154.5 million provided in 1985. The factors contributing to this decline include the reduced income before extraordinary items and the higher levels of capital spending for fixed assets and long-term intercorporate investments. These decreases were partially offset by the cash generated by elements of working capital. Particulars of the above items are as follows:

□ *Capital Spending:* The modernization program at Hilton Works was largely responsible for the increase in capital spending to \$273.5 million from the \$136.3 million spent in 1985. Included in the total spending for 1986 is \$249.4 million associated with manufacturing and mining facilities and \$24.1 million for long-term intercorporate investments. The long-term intercorporate investments were largely made to reduce the high interest rate bearing debt of an iron ore partnership and to provide additional operating funds.

□ *Operating Elements of Working Capital:* Details of these changes are given in the table on the bottom of the Consolidated Cash Flow Statement. Significant changes were:

- Accounts receivable declined \$22.5 million largely as a result of the absence in 1986 of a non-recurring sale of iron ore.
- Inventories decreased \$60.5 million primarily due to lower levels and prices of coal and ore.

Cash from Financing Activities: Overall financing activities provided \$70.4 million in cash in 1986 compared to \$8.2 million provided in 1985. The increased notes payable, described in Note 10, contributed \$108.0 million while the issue of common shares described previously under the heading Capital Structure added a further \$5.0 million. Offsetting these inflows was the reduction in long-term debt of \$41.1 million and the purchase of Preferred Shares for \$1.5 million.

Other Uses of Cash: Other uses of cash which include the payment of dividends and cash expenditures and adjustments associated with the extraordinary items resulted in a total outflow of \$119.8 million in 1986 versus \$87.7 million in 1985.

Cash Requirements

The overall result of the changes in cash flow has been a decrease of \$31.2 million in 1986 so that the 1986 year-end balance of cash and short term investments amounted to \$181.3 million. This balance although down from last year is still in excess of the Corporation's normal requirements. The funds are being held to provide for the potential retraction of Series A Preferred Shares on May 1, 1987.

Inflation

Inflation during 1986 was little changed from the 4% rate experienced in 1985. However, because certain balance sheet items are based on historical cost, they continue to be significantly distorted by the double digit inflation of prior years. For example, depreciation based on the reproduction cost* of the Corporation's fixed assets is estimated to exceed the reported depreciation based on historical cost by \$95 million. However, Stelco's investment in inventories is estimated to have decreased \$16 million in 1986 due to price reductions in raw materials, particularly coal and ore. It is management's view that the above two amounts give a simple yet reasonable indication of the impact of the effect of changing prices on Stelco's operations.

*Calculated using Statistics Canada's Implicit Price Indices for Non-Residential Construction and Machinery and Equipment.

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CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

Years ended December 31
(Thousands of Dollars)

		1986	1985
Revenue	Sales	\$ 2,400,253	\$ 2,434,656
	Equity income from corporate joint ventures and partnerships	7,542	790
	Income from short-term investments	20,139	17,673
	Gain on sale of portfolio investment	—	8,372
		2,427,934	2,461,491
Expense	Cost of sales, exclusive of the following items	2,055,312	2,048,952
	Administrative and selling	127,659	129,548
	Research and development	6,236	8,382
	Depreciation	104,350	104,031
	Interest on long-term debt	69,541	64,020
	Other interest	243	272
	Income taxes (Note 4) — current	7,419	10,729
	— deferred	3,355	10,331
		2,374,115	2,376,265
Income before extraordinary items		53,819	85,226
	Extraordinary items net of taxes (Note 3)	3,774	(7,577)
Net Income		57,593	77,649
Retained Earnings	Balance at beginning of year	582,963	590,397
	Dividends (Note 11)	(84,816)	(85,083)
	Balance at end of year	\$ 555,740	\$ 582,963
Income per common share (Note 1)	Before extraordinary items	\$.09	\$ 1.00
	— fully diluted	N/A	N/A
	After extraordinary items	\$.20	\$.77
	— fully diluted	N/A	N/A

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At December 31
(Thousands of Dollars)

Current Assets

	1986	1985
Cash	\$ 4,073	\$ 7,604
Short-term investments, at cost (approximates market value)	177,271	204,943
Accounts receivable	309,805	332,282
Inventories (Note 5)	677,559	738,045
Prepaid expenses	8,123	12,418

1,176,831 1,295,292

Current Liabilities

Accounts payable and accrued	323,000	354,199
Income and other taxes	53,335	46,702
Cash dividends payable	20,967	21,046
Long-term debt due within one year (Note 10)	21,854	24,900

419,156 446,847

Working Capital

(Note 11(b) Series A)	757,675	848,445
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Other Assets

Fixed assets (Note 6)	1,603,181	1,492,535
Long-term intercorporate investments (Note 7)	82,987	54,983
Deferred foreign exchange losses	42,397	51,215
Unamortized long-term debt issue expense	9,895	10,480

1,738,460 1,609,213

Total Investment

2,496,135 2,457,658

Other Liabilities

Provision for discontinuance of operations	—	1,750
Provision for blast furnace relines — beyond one year	102,498	83,898
Long-term debt (Note 10)	640,852	572,156
Deferred income taxes	215,498	239,537

958,848 897,341

Shareholders' Equity

\$ 1,537,287 \$ 1,560,317

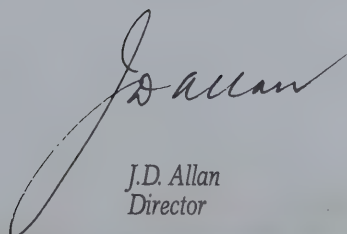
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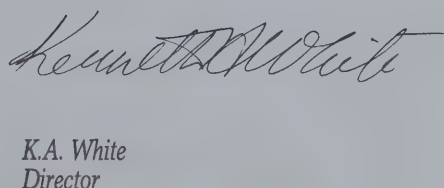
Capital Stock (Note 11)

Preferred shares	\$ 578,135	\$ 579,672
Common shares and warrants	388,520	397,614
Contributed surplus	14,849	—
Stock dividend to be issued	43	68
Retained Earnings	555,740	582,963

\$ 1,537,287 \$ 1,560,317

On behalf of the Board:


J.D. Allan
Director


K.A. White
Director

CONSOLIDATED STATEMENT OF CASH FLOW

Years ended December 31
(Thousands of Dollars)

**Cash from (used by)
Operations**

	1986	1985
Income before extraordinary items	\$ 53,819	\$ 85,226
Charges to income not affecting cash		
Depreciation	104,350	104,031
Increase in provision for blast furnace relines	18,600	23,138
Deferred income taxes	3,355	10,331
Expenditures for fixed assets	(249,361)	(132,100)
Long-term intercorporate investments — net	(24,149)	(4,153)
Changes in operating elements of working capital (see below)	99,950	47,157
Other — net	11,625	20,908
	18,189	154,538

**Cash from (used by)
Financing Activities**

Net proceeds from issue of notes payable (Note 10)	108,049	43,495
Net proceeds from issue of common shares (Note 11)	5,036	6,176
Reduction of long-term debt	(41,124)	(38,947)
Purchase of preferred shares (Note 11)	(1,534)	(2,479)
	70,427	8,245

**Other sources (uses)
of Cash**

Cash dividends paid	(84,203)	(85,303)
Payments and adjustments related to extraordinary items	(35,616)	(2,405)
	(119,819)	(87,708)

**Net Increase (Decrease)
in Cash**

(31,203) 75,075

**Cash and Short
Term Investments**

Balance at beginning of year	212,547	137,472
Balance at end of year	\$ 181,344	\$ 212,547

**Changes in
Operating Elements
of Working Capital
Providing (Utilizing)
Cash**

Accounts receivable	\$ 22,477	\$ (21,842)
Inventories	60,486	10,723
Prepaid expenses	4,295	(7,738)
Accounts payable (excluding extraordinary items)	6,059	63,020
Income and other taxes	6,633	2,994
	\$ 99,950	\$ 47,157

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1986

1 Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Stelco Inc. and its subsidiaries, all of which are wholly owned. Also included are the Corporation's pro-rata portions of the assets, liabilities, revenue and expenses of its unincorporated joint ventures. (See Note 7, also see page 41 for listing of Subsidiary Companies and Unincorporated Joint Ventures.)

Corporate joint ventures and partnerships, in all of which the Corporation has an interest of 50% or less, are accounted for by the equity method. (See Note 7, also see page 41 for listing of Corporate Joint Ventures and Partnerships.)

Foreign Currencies

Monetary assets and liabilities originating in foreign currencies are translated at year end exchange rates. All other assets and liabilities originating in foreign currencies are translated at historic rates prevailing when the assets were acquired or the liabilities incurred. Income and expense items, other than those related to assets and liabilities translated at historic rates, are translated at average rates prevailing during the year.

Unrealized gains or losses resulting from the translation of long-term debt at year end exchange rates are deferred and amortized over the remaining life of the debt. All other gains or losses resulting from foreign currency translations are reflected in the Consolidated Statement of Income.

Inventories

Inventories are valued at the lowest of cost, replacement cost and net realizable value. Physical quantities are normally confirmed once a year by count and for certain raw materials by aerial survey.

Fixed Assets and Depreciation

Fixed assets are recorded at historical cost less investment tax credits and include construction in progress. Depreciation is provided using the straight-line method applied to the cost of the assets at rates based on their estimated useful life and beginning from the point when production commences.

The following annual depreciation rates are in effect:

Buildings	2½ to 5%
Equipment	6 to 7½%
Automotive and mobile equipment	10 to 20%
Raw material plants and properties	4½ to 5%

Research and Development

Expenditures for research and development are expensed as incurred.

Interest

The interest cost of financing both working capital and capital expenditures is expensed as incurred.

Income Taxes

The Corporation provides for income taxes under the tax allocation basis of accounting whereby income taxes are provided for in the year in which the related income is reflected in the financial statements. Deferred income tax provisions result from timing differences in the recognition of income and expense for income tax and financial statement purposes. Investment tax credits are recorded using the cost reduction approach when there is reasonable assurance that such credits will ultimately be realized. Current and future income is affected to the extent that expenses or the cost of certain assets for depreciation purposes have been reduced by such investment tax credits.

Income Per Common Share

Income (loss) per common share both before and after extraordinary items are computed on the basis of their respective income (loss) for the year, less prescribed dividends on the preferred shares, divided by the weighted average of total Series A and Series B Convertible Common Shares outstanding during the year. Since the effect is antidilutive in 1986 and 1985, fully diluted income per common share both before and after extraordinary items has not been shown.

2 Segmented Information

The Corporation operates exclusively as a vertically integrated producer of a wide range of steel products which is its only line of business and dominant segment. Export sales of domestic production to foreign countries amounted to \$467 million in 1986 (\$501 million in 1985).

3 Extraordinary Items

In late 1986, due to lack of economic viability, a decision was made by the corporate shareholders of Olga Coal Company to indefinitely idle that West Virginia company in which the Corporation has a 10% interest. In 1986 the Corporation made an extraordinary charge of \$2.6 million (after estimated taxes recovery of \$1.3 million) for the write-off of its investment in Olga Coal Company and the estimated costs associated with the anticipated closure.

Offsetting this extraordinary charge, was an extraordinary gain in 1986 of \$6.4 million (after estimated taxes of \$3.9 million) resulting from actual costs associated with the planned shut down of specific facilities being lower than those originally provided for as extraordinary items in 1985 and 1984.

The above two matters resulted in a net 1986 extraordinary gain of \$3.8 million (after estimated taxes of \$2.6 million).

The extraordinary items in 1985 related to the closure and sale of certain facilities in the Montreal area which resulted in an extraordinary expense of \$7.6 million (after estimated taxes recovery of \$6.4 million).

4 Components of Consolidated Income Taxes

	1986 (in thousands)	1985 (in thousands)
Provision (recovery) based on combined basic Canadian federal and provincial income tax rates (1986 — 51%, 1985 — 51%)	\$ 32,943	\$ 54,206
Non-taxed equity income	(2,049)	(1,761)
Mining incentives	(16,757)	(14,459)
Inventory allowance	(1,138)	(9,521)
Capital gains	(212)	(2,746)
Other	(2,013)	(4,659)
Income taxes	\$ 10,774	\$ 21,060

5 Inventories

	1986 (in thousands)	1985 (in thousands)
Raw materials and supplies	\$ 295,755	\$ 348,366
Finished and semi-finished products	381,804	389,679
	\$ 677,559	\$ 738,045

6 Fixed Assets

	1986 (in thousands)	1985 (in thousands)
Raw material plants and properties	\$ 220,058	\$ 221,979
Manufacturing plants and properties	2,598,041	2,515,819
	2,818,099	2,737,798
Manufacturing plants and properties under capital lease (Note 8(c))	50,000	50,000
Less deferred gain (Note 8(c))	8,763	9,437
	41,237	40,563
	2,859,336	2,778,361
Less accumulated depreciation	1,537,600	1,452,826
	1,321,736	1,325,535
Construction in progress	281,445	167,000
	\$ 1,603,181	\$ 1,492,535

**7 Long-term
Investments and
Related
Commitments**

(a) Changes affecting investments in 1986 include the following:

On April 30, 1986 the Corporation entered into agreements to exchange, effective January 1, 1986, its entire (10%) interest in the Erie Mining Company for a 24.1% interest in the Hibbing Development Company, a partnership which has a 33 $\frac{1}{3}$ % interest in the Hibbing Taconite Company (an unincorporated joint venture). This exchange together with a previous 6.7% interest in the Hibbing Taconite Company gives the Corporation a total participation of 14.7% in the Hibbing Taconite Company's iron ore property.

The Corporation's 6.7% interest in the unincorporated joint venture continues to be consolidated on a pro-rata basis whereas the newly acquired 24.1% interest in the Hibbing Development Company partnership is accounted for by the equity method. (See Note 1 — Principles of Consolidation.)

(b) Long-term Intercorporate Investments	1986 (in thousands)	1985 (in thousands)
Corporate joint ventures and partnerships, at equity	\$ 81,034	\$ 53,030
Portfolio investments, at cost (quoted market value 1986 — \$1.9 million, 1985 — \$1.9 million)	1,953	1,953
	\$ 82,987	\$ 54,983

(c) Joint Ventures and Partnerships

Substantially, the joint ventures and partnerships are an integral part of steel operations and exist to provide raw materials, certain finishing operations and some administrative and sales services. Such transactions between the Corporation and the joint ventures and partnerships are accounted for in the Consolidated Statement of Income by:

- (i) Including such transactions with the joint ventures and partnerships in "Sales," "Cost of sales" or "Administrative" expense as appropriate.
- (ii) Disclosing the Corporation's share of the annual "Equity income from corporate joint ventures and partnerships" as a separate item of "Revenue". (In 1986 the cancellation of a long-term raw material contractual obligation provided non-recurring equity income of \$3.2 million.)

The following is a summary of the Corporation's proportionate share of the financial position of the joint ventures and partnerships:

	Unincorporated Joint Ventures	Corporate Joint Ventures and Partnerships	1986 (in thousands) Total	1985 (in thousands) Total
Assets	\$ 64,052	\$ 210,654	\$ 274,706	\$ 256,577
Liabilities	8,939	129,620	138,559	152,129
Equity	\$ 55,113	\$ 81,034	\$ 136,147	\$ 104,448

Included in the liabilities of the corporate joint ventures and partnerships is \$85.6 million of long-term debt against which certain assets relating to those entities have been pledged.

(d) Commitments

The Corporation, as a participant in certain of the corporate joint ventures and partnerships, is entitled to receive its proportionate share of coal and iron ore produced and is committed to pay its share of their costs, including minimum charges for principal and interest to cover the servicing of their long-term debt. The Corporation's share of such minimum charges averages US \$8 million annually to 1996. (See Note 16.)

8 Commitments

(a) Capital Programs

The estimated cost to complete capital programs including the Hilton Works modernization program is \$146 million which will be spent over a period of two years and includes an estimated amount of \$18 million to cover inflation in construction costs and other contingencies.

(b) Operating Leases

Future minimum rental payments required under operating leases that have initial or remaining lease terms in excess of one year at December 31, 1986 are:

	(in thousands)
1987	\$ 6,858
1988	6,266
1989	5,917
1990	5,803
1991	5,781
Subsequent to 1991	26,008
	\$ 56,633

(c) Capital Lease

In 1984 the Corporation sold at their fair market value of \$50 million certain assets associated with the slab caster located at Lake Erie Works. Effective January 1, 1985 these assets were leased back to the Corporation for a period of 15 years with an option to reacquire the assets at January 1, 1995 for \$25 million. The gain arising from the 1984 sale of assets is being amortized on a straight line basis over the period of the lease (see Note 6).

Future minimum rental payments required under the capital lease at December 31, 1986 are:

	(in thousands)
1987	\$ 6,667
1988	6,667
1989	6,667
1990	6,667
1991	6,667
Subsequent to 1991	53,343
	86,678
Less imputed interest at 10.37%	39,882
Present value of minimum lease payments included in long-term debt (Note 10)	\$ 46,796

9 Guarantee

In order to assist an unaffiliated corporation with its financial restructuring, the Corporation has entered into an agreement to pay the unaffiliated corporation's prime banker up to \$15 million in the event of a default under the restructuring. In return for support in this restructuring of the unaffiliated corporation, the Corporation has negotiated a steel supply contract, has been granted various forms of security and in the event that the guarantee is enforced has a variety of remedies.

10 Long-term Debt

	1986 (in thousands)	1985 (in thousands)
5 ⁷ / ₈ % sinking fund debentures due May 1, 1990	\$ 27,128	\$ 28,330
9 ¹ / ₄ % sinking fund debentures due November 1, 1990	40,912	43,768
10 ⁷ / ₈ % sinking fund debentures due September 15, 1994	47,040	47,898
9 ³ / ₄ % sinking fund debentures due April 1, 1995	71,850	75,906
10 ¹ / ₄ % sinking fund debentures due April 30, 1996	76,126	80,714
10% notes due October 15, 1987 (1985 — US \$5 million)*	—	6,540
10 ³ / ₄ % sinking fund notes due November 20, 1995 (1986 — US \$75 million, 1985 — US \$83 million)*	103,565	116,481
13 ¹ / ₂ % sinking fund debentures due October 1, 2000	92,310	100,010
	458,931	499,647
Capital lease (expiring January 1, 2000) (Note 8(c))	46,796	48,479
Notes payable (see below)	156,979	48,930
	662,706	597,056
Less amount due within one year, net of prepayments	21,854	24,900
	\$ 640,852	\$ 572,156

*Long-term debt payable in United States funds has been translated at the December 31 rates of exchange. This translated amount is not necessarily indicative of the amount which will be repaid when the obligations are retired.

On May 13, 1985 the Corporation entered into agreements, subsequently amended in 1986, which provided credit to finance the slab and bloom caster facilities at Hilton Works in the aggregate amount of \$270 million bearing a weighted average interest rate of 10.2% per annum. Principal repayments will commence five years after completion of the caster facilities (scheduled for the latter part of 1987). Repayments are to be completed by the earlier of 15 years from the caster completion date or April 30, 2003. At December 31, 1986 notes payable issued under the terms of these credit agreements were outstanding in the amount of \$157.0 million.

After allowing for prepayments and excluding capital leases, annual sinking fund and other repayments of debt over the next five years amount to \$20.0 million in 1987, \$31.1 million in 1988, \$32.0 million in 1989, \$89.7 million in 1990 and \$28.7 million in 1991.

11 Capital Stock and Dividends

(a) Authorized Shares

Under the Canada Business Corporations Act the Corporation is authorized to issue in series unlimited numbers of Preferred Shares and Common Shares without nominal or par value.

(b) Preferred Shares

	Number of Shares	1986 Stated Capital (in thousands)	Number of Shares	1985 Stated Capital (in thousands)
Outstanding				
— Series A	8,000,000	\$ 200,000	8,000,000	\$ 200,000
— Series B	1,615,550	40,389	1,676,900	41,923
— Convertible Series C	5,934,379	148,359	5,934,479	148,362
— Series D	4,175,491	104,387	4,175,491	104,387
— Series E	3,400,000	85,000	3,400,000	85,000
	23,125,420	\$ 578,135	23,186,870	\$ 579,672

Series A

These shares are entitled to a cumulative floating rate dividend, calculated and payable on a quarterly basis. The rate equals the sum of $1\frac{1}{4}\%$ and one-half the median Canadian bank prime rate charged by certain Canadian chartered banks.

The shares are redeemable on or after May 1, 1980 at \$25.75 per share, reducing by \$0.1875 annually on May 1, to \$25.00 per share. (In 1986 no shares were redeemed.)

The shares are retractable at \$25.00 per share at the holder's option, on May 1 in each of the years 1987, 1992 and 1997. If all shares outstanding at December 31, 1986 were retracted on May 1, 1987 Working Capital would be reduced by \$200 million.

Series B

These shares are entitled to a fixed cumulative dividend at the rate of \$1.94 per share annually, payable in equal quarterly instalments.

The shares are redeemable on or after November 1, 1984 at \$26.25 per share, reducing by \$0.25 annually on November 1, to \$25.00 per share. (In 1986 no shares were redeemed.)

On November 1 each year, the Corporation is required to purchase at \$25.00 per share 61,350 Series B Preferred Shares, if tendered. (On November 1, 1986, 61,350 shares with a stated capital of \$1,533,750 were tendered and purchased for a total consideration of \$1,533,750 and were cancelled.)

Convertible Series C

These shares are convertible into Series A Convertible Common Shares of the Corporation at any time on or before April 30, 1990, at a conversion price of \$33.75 per share, subject to adjustment in certain events. (In 1986, 100 shares with a stated capital of \$2,500 were converted into 74 Series A Convertible Common Shares.) The 5,934,379 shares with a stated capital of \$148,359,475 outstanding at December 31, 1986 were convertible at the option of the holders into 4,395,836 Series A Convertible Common Shares.

The shares are entitled to a fixed cumulative dividend at the rate of \$1.94 per share annually, payable in equal quarterly instalments.

The shares are redeemable on or after May 1, 1985 at \$26.25 per share, reducing by \$0.25 annually on May 1, to \$25.00 per share. (In 1986 no shares were redeemed.)

Commencing July 1, 1990, the Corporation is required to make all reasonable efforts to purchase during each calendar quarter, at a price not exceeding \$25.00 per share plus unpaid dividends and costs of purchase, 1% of the number of these shares outstanding on April 30, 1990. The resulting annual obligation expires December 31 in each year.

Series D

These shares are entitled to a fixed cumulative dividend at the rate of \$2.50 per share annually, payable in equal quarterly instalments.

The shares are redeemable on and after November 1, 1985 at \$26.00 per share, reducing by \$0.20 annually on November 1, to \$25.00 per share. (In 1986 no shares were redeemed.)

The shares are retractable at the option of the holder on November 1, 1990 at a price of \$25.00 per share.

The Corporation may elect in 1990 to create a further series of Preferred Shares ("1990 Series") into which the Preferred Shares Series D would be convertible on a share-for-share basis on and after the retraction date and having the same attributes in all material respects as the Preferred Shares Series D except that the dividend rate may be increased or decreased effective November 1, 1990 and the redemption price may be increased and a further non-call period may be provided.

During each calendar quarter the Corporation is required to make all reasonable efforts to purchase, at a price not exceeding \$25.00 per share plus costs of purchase:

- (i) from January 1, 1986 to December 31, 1990, 31,316 Preferred Shares Series D; and
- (ii) commencing January 1, 1991, 1.25% of the number of Preferred Shares Series D outstanding at close of business on November 1, 1990.

This purchase obligation is cumulative only within each calendar year, and would attach equally to shares of the 1990 Series. (In 1986 no shares were purchased.)

Series E

These shares are entitled to a fixed cumulative dividend at the rate of \$3.625 per share annually, payable in equal quarterly instalments.

The shares are redeemable on and after August 1, 1988 at \$26.20 per share, reducing by \$0.30 annually on August 1, to \$25.00 per share.

The shares are retractable at the option of the holder on August 1, 1988 at a price of \$25.00 per share.

The Corporation may elect on or before June 17, 1988 to create a further series of Preferred Shares into which the Preferred Shares Series E would be convertible on a share-for-share basis during a conversion period commencing no later than the retraction date and ending no earlier than six months after the retraction date (subject to prior redemption).

During each calendar quarter the Corporation is required to make all reasonable efforts to purchase, at a price not exceeding \$25.00 per share plus costs of purchase:

- (i) from October 1, 1982 to September 30, 1988, 17,000 Preferred Shares Series E; and
- (ii) commencing October 1, 1988, 1% of the number of Preferred Shares Series E outstanding at the close of business on September 30, 1988.

This purchase obligation is cumulative only within each calendar year. (In 1986 no shares were purchased.)

(c) Common Shares and Warrants

	1986	1985
Stated Capital — Common Shares	\$ 388,520	\$ 382,765
(in thousands) — Warrants	—	14,849
	\$ 388,520	\$ 397,614
Outstanding — Series A Convertible Shares	34,106,101	33,757,569
— Series B Convertible Shares	170,539	270,177
	34,276,640	34,027,746
Outstanding — Common Share Purchase Warrants	—	2,699,900

Series A and Series B

The Convertible Common Shares of each series are voting, convertible into one another on a share-for-share basis and rank equally in all respects except that dividends on the Series B Convertible Common Shares may be payable by way of a stock dividend in Series B Convertible Common Shares in accordance with the conditions attaching to such shares and dividends on the Series A Convertible Common Shares are payable in cash.

Convertible Common Shares issued during the year were:

- ☐ 4,572 Series A Shares for \$86,297 under the Employee Stock Investment Plan (see Note 12).
- ☐ 216,017 Series A Shares for \$4,950,151 under the Stelco Share Participation Plan (see Note 13).
- ☐ 28,290 Series B Shares in payment of stock dividends. Under terms of the issue, certain fractional Series B Shares with a stated capital of \$2,522 and equivalent to 109 whole shares were purchased and cancelled.

Warrants and Contributed Surplus

One whole Warrant entitled the holder to purchase one Series A Share at \$30.75 until October 15, 1986. In 1986, 50 Common Share Purchase Warrants were exercised. On October 15, 1986, 2,699,850 Warrants with a stated capital of \$14,849,175 expired and this amount has been transferred to "Contributed Surplus" from "Common Shares and Warrants" on the Consolidated Statement of Financial Position.

(d) Dividends

The following dividends were declared.

	1986 (in thousands)	1985 (in thousands)
Preferred Shares		
Series A (per share 1986 — \$1.64244, 1985 — \$1.68699)	\$ 13,140	\$ 13,496
Series B (per share 1986 — \$1.94, 1985 — \$1.94)	3,223	3,342
Convertible Series C (per share 1986 — \$1.94, 1985 — \$1.94)	11,513	11,513
Series D (per share 1986 — \$2.50, 1985 — \$2.50)	10,439	10,510
Series E (per share 1986 — \$3.625, 1985 — \$3.625)	12,325	12,325
	50,640	51,186
Common Shares		
(per share 1986 — \$1.00, 1985 — \$1.00)		
Series A	33,485	33,517
Series B (stock dividend)	691	380
	34,176	33,897
	\$ 84,816	\$ 85,083

12 *Employee Stock Investment Plan*

Under the Corporation's Employee Stock Investment Plan established in 1983, the Corporation is authorized to advance monies to a trustee to be loaned interest free to certain salaried employees and applied in payment of the subscription price of Series A Convertible Common Shares to be purchased from the Corporation by the trustee on behalf of such employees. The loans are secured by a pledge of the shares to the trustee and are normally repayable within five years of their inception. The Plan provides, on the occurrence of any of certain specified events, for special payments to a participant to discharge such participant's outstanding loans.

In December 1986, \$86,297 was advanced under the Plan for the purchase of an aggregate of 4,572 Series A Convertible Common Shares at a price of \$18.87 per share, the closing price on The Toronto Stock Exchange on December 19, 1986. At December 31, 1986 the amount of advances outstanding to the trustee under the terms of the plan was \$2,602,290.

13 *Stelco Share Participation Plan for Salaried Employees*

Effective January 1, 1984 the Corporation established a Share Participation Plan for all eligible non-bargaining unit employees. The Plan is funded by the Corporation through quarterly contributions to a trustee. Accumulated monthly entitlements are invested quarterly by the trustee in Series A Convertible Common Shares purchased from the Corporation at the closing sale price on the Toronto Stock Exchange on the third last working day of each calendar quarter.

This plan has been deemed an Employee Profit Sharing Plan by the federal and provincial tax authorities under the respective income tax acts and is reflected on the Consolidated Statement of Income in "Administrative and selling".

During 1986, 216,017 Series A Convertible Common Shares were issued under this Plan for total proceeds of \$4,950,151. Details of the shares issued each quarter are as follows:

	Number	Price	Amount
March	44,940	\$ 27.75	\$ 1,247,085
June	50,474	25.00	1,261,850
September	57,051	21.625	1,233,728
December	63,552	19.00	1,207,488
	216,017		\$ 4,950,151

14 *Retirement Plans*

Pension costs charged against income under the Corporation's pension plans include payments made to trust funds for current and past service requirements as determined by an independent actuary. Unfunded past service costs in respect of pensions ultimately payable to the present employees are estimated to be \$128 million at December 31, 1986. This amount is being funded over periods not exceeding fifteen years.

15 Related Party Transactions

Related party transactions occurring during 1986 and 1985 result from transactions with various corporate joint ventures and partnerships recorded as long-term intercorporate investments (see Note 7). These corporate joint ventures and partnerships accounted for on an equity basis exist to provide certain raw materials, finishing operations and administrative and sales services. Transactions during the year and balances outstanding at December 31 are as follows:

	1986 (in thousands)	1985 (in thousands)
(a) During the year		
Sales	\$ 7,801	\$ 3,879
Materials and services purchased	104,050	123,532
Capital advances (repayments)	30,615	11,385
Dividends and interest received	4,404	7,937
Advances (repayments) on demand notes	(800)	300
(b) At December 31		
Capital advances	\$ 95,225	\$ 64,610
Accounts receivable	630	2,195
Demand notes receivable	6,600	7,400

16 Contingency

The Corporation is a participant in a number of raw material properties with various U.S. participants of which some have filed for protection under Chapter 11 of the U.S. Bankruptcy Code. Currently some of such protected participants are not meeting their financial obligations under the terms of the joint venture (or partnership) agreements. Because of the complexity of the issues and the various courses of action available to the parties involved, it is not possible at this time to determine the ultimate resolution of these issues or their impact on the Corporation. Accordingly, no provision for the ultimate loss, if any, from these issues has been made in these financial statements. (See Note 7 for details of Corporate Joint Ventures and Partnerships and Commitments.)

17 Comparative Figures

Certain 1985 comparative figures have been reclassified to conform with the financial statement presentation adopted for 1986.

AUDITORS' REPORT

**THORNE
RIDDELL**

Chartered Accountants

To The Shareholders
Stelco Inc.

We have examined the consolidated statement of financial position of Stelco Inc. at December 31, 1986 and the consolidated statements of income and retained earnings and cash flow for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the corporation at December 31, 1986 and the results of its operations and the changes in its cash position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.



Toronto, Canada
February 10, 1987

INVESTOR INFORMATION

Shares

The Series A Convertible Common Shares and the Series B Convertible Common Shares of the Corporation and are listed on The Toronto Stock Exchange, The Montreal Exchange, and the Vancouver Stock Exchange.

The Preferred Shares Series C, Series D and Series E are listed on The Toronto Stock Exchange and The Montreal Exchange.

The rights and privileges of each class of shares are set out in the financial statement section of this Annual Report.

At December 31, 1986, there were 19,740 holders of common shares. Approximately 97% of these shareholders had Canadian addresses.

The reported high and low sales prices of Stelco Inc. common shares in 1986 and 1985 are shown in the following table:

Quarter	1986		1985	
	High	Low	High	Low
First	\$ 28.50	\$ 22.12	\$ 24.25	\$ 20.00
Second	28.75	24.12	20.87	18.75
Third	25.37	20.50	23.62	19.12
Fourth	23.75	17.75	24.12	19.62

The valuation day value of the Corporation's common shares was \$26.75.

Dividends

Dividends on all classes of shares are payable quarterly on February 1, May 1, August 1, and November 1 of each year.

Dividends have been paid on common shares since 1916. Common share dividends have been paid at a rate of 25¢ per share per quarter since the May 1, 1982 dividend payment.

Transfer Agent

The Preferred Shares series C, D and E, and the Common Shares Series A and B are transferable through the Corporation's Transfer Agent, The National Trust Company, at their offices in Toronto, Montreal, Hamilton, Winnipeg, Regina, Edmonton and Vancouver, and at its Agent, The Royal Trust Company in Halifax.

Investor Inquiries

Questions and comments regarding Stelco Inc. or any information appearing in the Annual Report, Quarterly Reports or any other corporate publication may be directed to the Vice-President, Secretary and General Counsel.

TEN-YEAR STATISTICAL SUMMARY

		1986	1985	1984	1983
<i>Dollars in millions except as indicated*</i>					
Operations (thousands of net tons)					
	Raw steel produced	4,880	4,991	5,145	4,778
	Total raw steel processed (including purchases)	5,137	5,109	5,161	4,657
	Steel shipments	4,003	4,023	4,004	3,598
Income and Related Data					
	Sales	\$ 2,400.3	2,434.7	2,401.2	2,033.2
	Administrative and selling	\$ 127.7	129.5	128.7	121.6
	Depreciation	\$ 104.4	104.0	111.5	103.8
	Interest on long-term debt	\$ 69.5	64.0	58.9	61.0
	Income taxes	\$ 10.8	21.1	(1.7)	(50.4)
	Net income (loss)	\$ 57.6	77.6	(3.3)	(14.2)
	Per common share ⁽²⁾	*\$.20	.77	(1.69)	(2.32)
	— fully diluted	*\$ N/A	N/A	N/A	N/A
	Return on sales	% 2.2 **	3.5 **	2.0 **	(0.7)
	Return on average investment ⁽³⁾	% 3.5 **	4.7 **	3.2 **	0.7
	Return on average common shareholders' equity ⁽²⁾	% 0.3 **	3.4 **	(0.4) **	(7.0)
	Dividends declared — preferred	\$ 50.6	51.2	52.2	52.0
	— common	\$ 34.2	33.9	33.6	28.9
	Per common share	*\$ 1.00	1.00	1.00	1.00
	Earnings reinvested in (withdrawn from) the business	\$ (27.2)	(7.5)	(89.1)	(95.2)
Capital Expenditures		\$ 273.5	136.3	32.4	44.9
Financial Position, year end					
	Working capital	\$ 757.7	848.4	853.8	692.3
	Fixed assets — net	\$ 1,603.2	1,492.5	1,484.4	1,625.0
	Long-term debt	\$ 640.9	572.2	555.2	509.9
	Preferred shareholders' equity	\$ 578.1	579.7	582.2	583.7
	Common shareholders' equity	\$ 959.2	980.6	981.5	981.0
	Per common share	*\$ 27.98	28.82	29.11	32.35
Employment					
	Average number of employees	17,768	18,773	20,612	19,519
	Total employment costs	\$ 803.8	828.7	870.9	782.6
	Employees' average weekly earnings ⁽⁴⁾	*\$ 731.35	694.60	663.02	627.04
Number of Common Shareholders year end					
		19,740	22,373	24,416	27,072

(1) 1981 operations were interrupted by strikes, 125 days at Hilton Works and for various periods at other locations.

(2) After preferred dividends. (See Note 1 on page 26 for explanation of computation of net income (loss) per common share.)

(3) After adding back interest on long-term debt (net of tax) to net income (loss).

(4) Excludes the cost of supplementary employment benefits.

** Calculated before extraordinary items \$3.8 million gain (\$.11 per share) in 1986 — \$7.6 million loss (\$.23 per share) in 1985 — \$51.6 million loss (\$1.57 per share) in 1984.

1982	1981 ⁽¹⁾	1980	1979	1978	1977
4,592	4,454	6,278	5,862	5,533	5,640
4,667	4,996	6,109	6,306	6,199	5,490
3,575	3,804	4,529	4,553	4,466	3,995
2,020.3	2,173.8	2,228.6	2,091.2	1,775.7	1,444.1
129.2	120.3	111.0	98.7	88.5	81.8
101.0	93.6	70.3	60.5	56.7	55.1
63.6	65.4	55.3	52.5	52.5	51.4
(64.8)	17.8	39.5	62.0	39.3	1.6
(40.8)	82.8	132.2	156.9	111.9	81.9
(3.69)	1.45	4.05	5.74	4.07	3.02
N/A	N/A	3.88	N/A	N/A	N/A
(2.0)	3.8	5.9	7.5	6.3	5.7
(0.4)	4.6	6.9	9.1	7.3	6.3
(9.3)	3.4	9.7	14.7	11.3	8.8
51.1	47.7	34.0	15.4	11.5	8.2
24.8	49.5	49.4	49.4	43.2	42.0
1.00	2.00	2.00	2.00	1.75	1.70
(116.7)	(14.4)	48.8	92.0	57.2	31.7
163.2	210.2	191.7	204.0	145.3	144.6
649.2	791.4	930.7	617.1	593.6	603.3
1,687.5	1,634.9	1,517.3	1,397.4	1,265.7	1,186.1
535.0	558.1	581.0	490.4	496.9	501.3
585.5	504.2	508.0	233.1	200.0	200.0
925.5	1,042.5	1,054.7	1,009.6	917.7	860.3
37.25	42.07	42.66	40.85	37.13	34.83
22,104	26,263	25,094	25,032	23,712	22,942
799.7	674.6	687.9	641.6	559.0	495.0
574.71	492.25	443.94	408.75	374.98	343.67
29,551	32,277	36,040	40,495	38,147	36,408

DIRECTORS AND OFFICERS

Directors***§J.D. Allan, Toronto***Chairman, President and Chief Executive Officer of the Corporation****‡Alex E. Barron, Toronto***Vice-Chairman, Canadian General Investments Limited****A. Jean de Grandpré, Montreal***Chairman and Chief Executive Officer, Bell Canada Enterprises Inc.****‡Thomas M. Galt, Toronto***Chairman and Chief Executive Officer, Sun Life Assurance Company of Canada****J. Peter Gordon, Toronto***Corporate Director***J. Howard Macdonald, Calgary***Chairman and Chief Executive Officer, Dome Petroleum Limited****A.J. MacIntosh, Toronto***Partner, Messrs. Blake, Cassels & Graydon, Barristers & Solicitors***†‡William F. McLean, Toronto***Corporate Director***J. Dean Muncaster, Toronto***Corporate Director***§J. Fraser Mustard, Toronto***President, The Canadian Institute for Advanced Research***†Lucien G. Rolland, Montreal***Chairman and Chief Executive Officer, Rolland inc.***†Kenneth A. White, Oakville***Corporate Director***§Marshall M. Williams, Calgary***Chairman and Chief Executive Officer, TransAlta Utilities Corporation***§L.R. Wilson, Toronto***President and Chief Executive Officer, Redpath Industries Limited***†*William H. Young Hamilton***Corporate Director***Member — Executive Committee**†Member — Audit Committee**‡Member — Compensation and Manpower Resources Committee**§Member — Strategic Planning Committee***Executive Officers****J.D. Allan***Chairman, President and Chief Executive Officer***G.W.R. Bowlby***Executive Vice President***R.E. Heneault***Executive Vice President***J.E. Hood***Executive Vice President***G. Binnie***Vice President and Comptroller***P.D. Matthews***Vice President and Treasurer***J.W. Younger***Vice President, Secretary and General Counsel***Vice Presidents and Other Officers****W.C. Ashcroft***Assistant Treasurer***V.P. Harris***Vice President — Industrial Relations***W.A. Hopkins***Vice President and General Manager — Stelco Pipe and Tube Company***L.M. Killaly***Assistant Secretary***L.C. McLean***Vice President — Quality and Technology***T.R. Meadowcroft***Vice President — Manufacturing***D.B. Morrow***Vice President and General Manager — Stelco Fastener and Forging Company***A.G. Northcott***Assistant Comptroller — Works Accounting***P.J. Prediger***Vice President and General Manager — Stelco Wire Products Company***F.H. Telmer***Vice President — Corporate Affairs and Strategic Planning***D.A. Woodward***Vice President — Sales*

CORPORATE DIRECTORY

Head Office

IBM Tower,
Toronto-Dominion Centre
Toronto, Ontario, M5K 1J4

General Offices

Hamilton, Ontario
Montreal, Quebec — Eastern Region
Edmonton, Alberta — Western Region

Sales Offices

Hamilton, Ontario
Montreal, Quebec
Calgary, Alberta
Edmonton, Alberta
St. John's, Newfoundland
Windsor, Ontario

Core Business Plants**Steelmaking**

Hilton Works, Hamilton, Ontario
Lake Erie Works, Nanticoke, Ontario
McMaster Works, Contrecoeur,
Quebec
Edmonton Steel Works, Edmonton,
Alberta

Raw Material

Chemical Lime Works, Beachville,
Ontario

Business Units**Stelco Fastener and Forging Company**

Swansea Works, Toronto, Ontario
Brantford Works, Brantford, Ontario
Distribution Centre, Burlington,
Ontario
Gananoque Works, Gananoque,
Ontario

Stelco Wire Products Company

Parkdale Works, Hamilton, Ontario
Frost Works, Hamilton, Ontario
Dominion Works, Lachine, Quebec
Continuous Rod Processing Plant,
Burlington, Ontario

Stelco Pipe and Tube Company

Page-Hersey Works, Welland,
Ontario
Welland Tube Works, Welland,
Ontario
Camrose Works, Camrose, Alberta
Edmonton Finishing Works,
Edmonton, Alberta

Canadian Drawn Steel Company

Canadian Drawn Works, Hamilton,
Ontario

Avenue Studios

Hamilton, Ontario

Research Centre

Burlington, Ontario

Subsidiary Companies, wholly owned*

Clôture Frost Inc. — Frost Fence Inc., Montreal, Que.
Stelco Holding Company, Cleveland, Ohio
Stelco Coal Company, Pittsburgh, Pa.
Pikeville Coal Co., Louisville, Ky. (Chisholm Mine)
Kanawha Coal Company, Ashford, W. Va. (Madison Mine)
Ontario Eveleth Company, Minneapolis, Minn.
Ontario Hibbing Company, Minneapolis, Minn.
Stelco U.S.A. Inc., Troy, Michigan

Unincorporated Joint Ventures*

	% Owned
Moly-Cop Canada, Alta. & B.C.	50.0
Wabush Mines, Nfld. & Que.	25.6
Hibbing Taconite Company, Minn.	6.7

Corporate Joint Ventures and Partnerships

	% Owned
Iron Ore	
Eveleth Expansion Company, Minn.	23.5
Tilden Iron Ore Partnership, Mich.	15.6
Hibbing Development Company, Minn.	24.1
Ontario Iron Company, Minn.	10.0

Coal

Mathies Coal Company, Pa.	13.3
Beckley Coal Mining Company, W. Va.	12.5
Olga Coal Company, W. Va.	10.0

Other

Baycoat Limited, Ont.	50.0
Fers et Métaux Recyclés Ltée, Que.	50.0
Stow International B.V., The Netherlands	50.0
Stelco S.A., Switzerland	50.0
Stelco de Argentina, S.A.C.I. y de R., Argentina	50.0
Stelco de Venezuela, S.R.L., Venezuela	50.0
Torcad Limited, Ont.	50.0
Arnaud Railway Company, Que.	25.6
Wabush Lake Railway Company, Limited, Nfld.	25.6
Canada Systems Group Limited, Ont.	25.5
Knoll Lake Minerals Limited, Nfld.	14.9
Northern Land Company Limited, Nfld.	12.8
Twin Falls Power Corporation, Limited, Nfld.	4.4

Registrar and Transfer Agent

National Trust Company, Toronto, Montreal, Hamilton, Winnipeg, Regina,
Edmonton and Vancouver; and its agent Royal Trust Company in Halifax.

*Excludes inactive Subsidiary Companies and inactive Unincorporated Joint Ventures.

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Quality people. Quality steel.